



Early Journal Content on JSTOR, Free to Anyone in the World

This article is one of nearly 500,000 scholarly works digitized and made freely available to everyone in the world by JSTOR.

Known as the Early Journal Content, this set of works include research articles, news, letters, and other writings published in more than 200 of the oldest leading academic journals. The works date from the mid-seventeenth to the early twentieth centuries.

We encourage people to read and share the Early Journal Content openly and to tell others that this resource exists. People may post this content online or redistribute in any way for non-commercial purposes.

Read more about Early Journal Content at <http://about.jstor.org/participate-jstor/individuals/early-journal-content>.

JSTOR is a digital library of academic journals, books, and primary source objects. JSTOR helps people discover, use, and build upon a wide range of content through a powerful research and teaching platform, and preserves this content for future generations. JSTOR is part of ITHAKA, a not-for-profit organization that also includes Ithaka S+R and Portico. For more information about JSTOR, please contact support@jstor.org.

STOCK DIVIDENDS, DIRECT TAXES, AND THE SIXTEENTH AMENDMENT

EISNER *v.* MACOMBER

By the familiar five-to-four vote, the Supreme Court held in *Eisner v. Macomber*¹ that Congress may not tax stock dividends as income. Only Mr. Justice Brandeis and Mr. Justice Clarke thought that stock dividends really are income, and possibly even they did not go quite so far. They had agreed in *Towne v. Eisner*² that the word "income" in an Act of Congress should not be taken to include a stock dividend. They acquiesced in the analysis that a stock dividend is nothing but a rearrangement of the indicia of what is already capital to the stockholder. As Mr. Justice Holmes put it: "In short, the corporation is no poorer and the stockholder is no richer than they were before."³ Hypothetically conceding that the stockholder may gain some advantage from the change, the acute Justice pointed out that it was not worth the value of the dividend. He left the door open, however, for a more liberal interpretation of "incomes" as used in the Constitution.⁴ So Mr. Justice Brandeis and Mr. Justice Clarke very likely go no further in *Eisner v. Macomber* than to insist that a stock dividend is so much like other things held to be taxable income that Congress should be allowed to put it in the same category.

Mr. Justice Holmes and Mr. Justice Day rest their dissent on somewhat different grounds. They thought it unnecessary to establish that a stock dividend may properly be called "income" in order to render it taxable by Congress without apportionment among the states according to population. No one doubts that stock dividends are taxable by Congress as well as by the states. But if a tax on stock dividends is a direct tax, it is one which,

¹(March 8, 1920) 40 Sup. Ct. 189.

²(1918) 245 U. S. 418, 38 Sup. Ct. 158.

³*Ibid.*, at p. 426.

⁴"But it is not necessarily true that income means the same thing in the Constitution and the act. A word is not a crystal, transparent and unchanged; it is the skin of a living thought and may vary greatly in color and content according to the circumstances and the time in which it is used." *Ibid.*, at p. 425. Mr. Justice McKenna was the only member of the court who implied any dissent from this conception of a word as a chameleon. He confined his concurrence to the result.

prior to the Sixteenth Amendment,⁵ Congress would have to spread among the states, not according to the value of the dividends received in each state, but according to the number of folks living there. Mr. Justice Holmes says that the "known purpose" of the Sixteenth Amendment was "to get rid of nice questions as to what might be direct taxes", and that he "cannot doubt that most people not lawyers would suppose when they voted for it that they put a question like the present to rest."⁶

I

Mr. Justice Holmes's mind-reading is very likely correct. When in 1881 the Supreme Court held in *Springer v. United States*⁷ that a tax on income is an indirect tax, it declared that "*direct taxes*, within the meaning of the Constitution, are only capitation taxes, as expressed in that instrument, and taxes on real estate."⁸ Then along came *Pollock v. Farmers' Loan & Trust Co.*⁹ in 1895, affirming for the first time that a tax on income is in substance the same as a tax on the source thereof, that a tax on personal property is as direct as a tax on land, and hence that a tax on the income from either is a direct tax. This conclusion was reached over the vehement protests of four of the judges. No one was more vigorous in his dissent than Mr. Justice White, the present Chief Justice whose vote was essential to the majority in *Eisner v. Macomber*. He protested that if previous decisions were to be repudiated, it should be done by constitutional amendment,¹⁰ and argued that if the possibility of such apostasy had been

⁵"The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration."

⁶40 Sup. Ct. 189, 204. This is preceded by the statement: "I think that the word 'incomes' in the Sixteenth Amendment should be read in 'a sense most obvious to the common understanding at the time of its adoption' . . . For it was for public adoption that it was proposed." Thus Mr. Justice Holmes seems to convey two ideas; (1) that the folks from whom the Sixteenth Amendment derives its force would think of a stock dividend as "income"; and (2) that they intended by the Amendment to make a tax on stock dividends and indirect tax whether such dividends are income or not.

⁷(1880) 102 U. S. 586.

⁸*Ibid.*, at p. 602.

⁹(1895) 157 U. S. 429, 15 Sup. Ct. 673. On rehearing: (1895) 158 U. S. 601, 15 Sup. Ct. 912.

¹⁰(1895) 157 U. S. 429, 639, 15 Sup. Ct. 673.

anticipated, a constitutional amendment in all probability would have been adopted to forestall it.¹¹

The Pollock Case, with its abandonment of previously well-established doctrine, provoked widespread popular criticism. Then followed the movement for the Sixteenth Amendment and its ultimate adoption. The Amendment was very probably widely regarded as in effect a "recall" of the Pollock Case, as the Eleventh Amendment was a recall of *Chisholm v. Georgia*.¹² Without imputing to the man in the street or in the state legislatures a careful reading of Mr. Justice White's dissenting opinions, we may nevertheless assume without undue violence that the Income Tax Cases of 1895 were regarded as amendments of what had gone before and that the Sixteenth Amendment was looked upon as a restorative. Careful lawyers who read Mr. Justice White's suggestion that the Constitution would probably have been amended to make the Pollock Case impossible, had its possibility been anticipated, might well have thought that the Sixteenth Amendment was a device to repair the damage done to the Springer Case by that bare majority in the Pollock Case.

The attitude of Mr. Justice Holmes is in harmony with Marshall's insistence that the objects of the Constitution should have great weight in settling its interpretation.¹³ It is the view of a statesman recognizing the political element in constitutional construction. There is wisdom in the position that the Supreme Court needs a clear mandate in order to declare an Act of Congress unconstitutional. Judicial professions of this canon are numerous. Mr. Justice Holmes is one of the judges who take those professions seriously. They are relied on also by Mr. Justice Brandeis in his dissent. They are not referred to in the majority opinion.¹⁴ Mr. Justice Pitney follows literary and economic lines.

¹¹(1895) 158 U. S. 601, 715, 15 Sup. Ct. 912.

¹²(1793) 2 Dall. (2 U. S.) 419.

¹³*McCulloch v. Maryland* (1819) 4 Wheat. (17 U. S.) 316, 407.

¹⁴Mr. Justice Pitney says: "Congress cannot by any definition it may adopt conclude the matter, since it cannot by legislation alter the Constitution, from which alone it derives its power to legislate, and within whose limitations alone that power can be lawfully exercised." (40 Sup. Ct. 189, 193.) This assumes an objective repugnance between the Constitution and the statute, whenever a majority of the Court finds such a repugnance. If this assumption were philosophically warranted, it would follow that either in the Springer Case or in the Pollock Case, the Supreme Court by judicial decision altered the Constitution.

He thinks that the only question is whether the word "incomes" in the Sixteenth Amendment is an apt characterization of stock dividends. He says that it is not. Therefore the Sixteenth Amendment is dismissed from consideration. A stock dividend is capital. A tax on capital, according to the Pollock Case, is a direct tax. For failure to apportion this direct tax on stock dividends among the states according to population, Congress has transgressed constitutional restrictions and its action is null and void.

Such is the position of the majority. One possible objection to it was not mentioned in any of the three opinions in the case. Grant that a stock dividend is capital after it is received. So is a cash dividend. Both may have been capital before received. But Congress does not tax either as capital. They were subject to levy only in the year in which they are received. It was the receipt, not the ownership, of the stock dividend that made it taxable. This receipt is a taxable event. Taxes on events such as business transactions are indirect taxes, even though the transaction is only a change in the form of capital assets. Direct taxes are those which are imposed on property as such, or those which are thought to have the same results. Income is the normal, recurring fruit of property, and a tax thereon has substantially the same effect as a tax on the property itself. But stock dividends are occasional and spasmodic. It can hardly be doubted that an isolated federal tax on stock dividends would be held an indirect tax, as is a tax on an agreement to sell a share of corporate stock.¹⁵

It should not greatly matter that Congress miscalls a stock dividend income, if it may impose the same tax under a proper caption.¹⁶ It does, however, raise a genuine difficulty when surtaxes are based, as in the Act of 1916,¹⁷ on a combination of stock dividends and of concededly taxable income. This difficulty and possible ways of overcoming it, I plan to consider elsewhere, if some editor will permit. The obstacle can be surmounted by tra-

¹⁵Thomas v. United States (1904) 192 U. S. 363, 24 Sup. Ct. 305.

¹⁶Cf. Chief Justice Fuller in *Postal Telegraph Cable Co. v. Adams* (1895) 155 U. S. 688, 700, 15 Sup. Ct. 268: "literal adherence to particular nomenclature should not be allowed to control construction in arriving at the true intention and effect of state legislation."

¹⁷39 Stat. 756.

ditional modes of legal thought,¹⁸ and the ground thus gained can be beautified by considerations of substance. The present discussion, however, is confined to hinting that the point that a stock dividend was taxed not as capital but as a transaction or event seems too important to have been entirely overlooked.¹⁹ It offers at least an added make-weight to the contention that Congress should be given the benefit of every doubt.

II

The majority opinion in *Eisner v. Macomber* falls into three fairly distinct divisions. One deals with the relation of the Sixteenth Amendment to the problem before the court. The majority do not take Mr. Justice Holmes's latitudinarian view of the Amendment. On the contrary, says Mr. Justice Pitney:

"A proper regard for its genesis, as well as its very clear language, requires also that this Amendment shall not be extended by loose construction, so as to repeal or modify, except as applied to income, those provisions of the Constitution that require an apportionment according to population for direct taxes upon property, real and personal. This limitation still has an appropriate and important function, and is not to be overridden by Congress or disregarded by the courts."²⁰

Looking at the Amendment literally, the majority insist that it has no application except to taxes really on incomes. It did not abolish the Pollock Case, but merely prevented the court from looking at the source of income in order to determine whether a tax on income was direct or indirect. "As repeatedly held, this did not extend the taxing power to new subjects, but merely re-

¹⁸For example, those used in *Flint v. Stone Tracy Co.* (1910) 220 U. S. 107, 31 Sup. Ct. 342, *Kansas City, M. & B. R. Co. v. Stiles* (1916) 242 U. S. 111, 37 Sup. Ct. 56, and *Maxwell v. Bugbee* (1919) 250 U. S. 525, 40 Sup. Ct. 2.

¹⁹It may be noted that Mr. Justice Pitney in the principal case refers to the Pollock Case as one in which "it was held that taxes . . . upon returns from investments of personal property were in effect direct taxes upon the property from which such income arose, *imposed by reason of ownership*." (40 Sup. Ct. 189, 192. *Italics mine*.) The Pollock Case had to do with normal, recurring income. Even if a stock dividend were thought to be income, it would be an extraordinary sort of income, payable only spasmodically and by a peculiar process. A tax thereon may be regarded as one imposed, not by reason of ownership of the parent stock, but by reason of the extraordinary character of the dividend and the mode of its transmittal. If the mode of transmittal prevents the stock dividend from being income, then the transaction is not within the Pollock Case.

²⁰40 Sup. Ct. 189 at p. 193.

moved the necessity which might otherwise exist for an apportionment among the States of taxes laid on income."²¹

Whether this had been repeatedly *held*, is perhaps open to question. It had been repeatedly declared, but it is by no means clear that these observations were essential to the decisions. In *Brushaber v. Union Pacific Railroad Co.*,²² Chief Justice White adduced this interpretation of the Amendment to meet certain objections to the Income Tax of 1913.²³ The contentions of the resisters were that the Amendment gave a new power to tax income, that therefore a statute dependent thereon could not operate retroactively, and that the exemption of certain income prevented the tax from being one on "incomes from whatever source derived." The first of these complaints would be answered sufficiently by saying that the retroactivity of the statute halted at the effective date of the Sixteenth Amendment. The simple reply to the second would be that "from whatever source derived" is equivalent to "from all or any" rather than to "from all but not less than all." Such answers would have met the objections urged and avoided an interpretation which might raise questions as to the constitutionality of legislation quite different from that then before the court. An exegesis unnecessarily put forward to sustain a statute ought not to be blindly accepted as unquestioned gospel by which to condemn another statute to unconstitutionality. Therefore Chief Justice White's analysis in the *Brushaber* Case ought not to have been taken as a prejudgment of the issue raised by the *Stock Dividend* Case. Mr. Justice Holmes and Mr. Justice Day evidently did not so regard it, for they concurred in the *Brushaber* Case and in those following it,²⁴ and yet felt free in the *Macomber* Case to construe the Sixteenth Amendment independently.

III

Another division of Mr. Justice Pitney's opinion in the *Macomber* Case tells why a stock dividend is not income. *Towne v. Eisner*²⁵ is thought to be conclusive; "not because that case in

²¹Citing *Brushaber v. Union Pacific R. R. Co.* (1916) 240 U. S. 1, 17-19, 36 Sup. Ct. 236, *Stanton v. Baltic Mining Co.* (1916) 240 U. S. 103, 112 *et seq.*, 36 Sup. Ct. 278, and *Peck & Co. v. Lowe* (1918) 247 U. S. 165, 172, 173, 38 Sup. Ct. 432.

²²(1916) 240 U. S. 1, 36 Sup. Ct. 236.

²³38 Stat. 166.

²⁴Cases cited in note 20, *supra*.

²⁵(1918) 245 U. S. 418, 38 Sup. Ct. 158, note 2, *supra*.

terms decided the constitutional question, for it did not; but because the conclusion there reached as to the essential nature of a stock dividend necessarily prevents it being regarded as income in any true sense."²⁶ Yet because of the importance of the question and because Congress thought stock dividends are income, the opinion proceeds to further analysis. The determining reason why a stock dividend is not income is that the corporation parts with nothing. Its assets remain intact. Therefore the stockholder gets nothing. There is no income because nothing comes in. Income from capital must be a gain *derived* from capital. "Derived" necessarily connotes the idea of "proceeding from", "severed from". There must be something "*received* or *drawn* by the recipient (the taxpayer) for his *separate* use, benefit and disposal".²⁷ The stock dividend adds nothing to the property of the shareholder. It gives him only new pieces of paper which stand for a part of what his old pieces of paper stood for and which make those old pieces correspondingly less valuable. If the stock dividend represents to some extent an increment in the stockholder's interest in the corporation, it is not a severed increment. The new stock may change somewhat the stockholder's control over what the corporation may do with its assets; but this, instead of being income to the stockholder, is merely a change in the characteristics of his capital.

Such in substance is the positive ground of the decision. In so far as it holds the idea that a stock dividend is not gain to the stockholder, it gives the best of reasons why it is not income to him. Clearly, on any rigorous analysis, gain must be essential to the concept of income. Otherwise, changes in the form of a man's investments within a single year might subject him to a so-called income tax greater than his total wealth. Whether a stock dividend represents a gain to the stockholder depends upon the circumstances under which he acquired his parent stock. The Act of 1916 did not inquire into this. The stockholder was assessed on the cash value of the dividend even if he had parted with his capital to buy the expectancy the week before. If gain or profit is essential to the idea of income from property, any tax on stock dividends as income would be vicious unless it allowed the taxpayer to show how much richer the dividend had made him and restricted the assessment to that amount.

²⁶(1920) 40 Sup. Ct. 189, 192.

²⁷*Ibid.*, at p. 193.

IV

To a wayfaring man, it might seem strange that the court did not lay chief stress on the absence of gain or profit rather than on the want of severance. But to one familiar with earlier decisions, the reason is apparent. For stockholders are held to derive taxable income through some fruits of their holdings though these fruits are not gains or profits. In *Lynch v. Hornby*,²⁸ a stockholder was held to receive income when a cash dividend was declared and paid to him after the effective date of the Act of 1913, though the dividend came from assets accumulated by the corporation prior to the effective date of the Sixteenth Amendment. In *Peabody v. Eisner*,²⁹ a distribution by a corporation of its stock holdings in another corporation was held income to its stockholders, although the stock distributed had been acquired before the Sixteenth Amendment. In these two cases, any possible gain accruing to the stockholders was accumulated capital to the corporation and in economics part of the capital value of the shareholder's stock before an unapportioned income tax on the stockholder was possible.

These two cases were Mr. Justice Brandeis's best levers. He relied on the fundamental similarity between "two different methods by which a corporation can, without increasing its indebtedness, keep for corporate purposes accumulated profits, and yet, in effect, distribute these profits among its stockholders."³⁰ One is the extraordinary cash dividend accompanied by an opportunity to purchase additional stock. *Lynch v. Hornby* holds this cash dividend taxable to the stockholder as income. The other is the issue to him direct of the new stock. This is as close to cash as is the stock of a subsidiary corporation held income in *Peabody v. Eisner*. Though the sale of the stock dividend reduces the stockholder's proportionate interest in the corporation, the same result follows from a use of the cash dividend for any other purpose than the purchase of new stock. Thus two characteristics of stock dividends are dismissed as irrelevant. It does not matter that it is not cash. It is immaterial that turning it into cash reduces the stockholder's fractional interest in the corporation.

Mr. Justice Pitney does not directly meet these arguments

²⁸ (1918) 247 U. S. 339, 38 Sup. Ct. 546.

²⁹ (1918) 247 U. S. 347, 38 Sup. Ct. 546.

³⁰ (1920) 40 Sup. Ct. 189, 197.

based on the combination of *Lynch v. Hornby* and *Peabody v. Eisner*. He says that "if a shareholder sells dividend stock he necessarily disposes of a part of his capital interest"³¹ and that "his part in the control of the company likewise is diminished."³² But, as Mr. Justice Brandeis points out, neither of these incidents separately prevents what the stockholder receives from being regarded as income. In all substance Mr. Justice Pitney bumps headlong into *Peabody v. Eisner* when he says: "Nothing could more clearly show that to tax a stock dividend is to tax a capital increase, and not income, than this demonstration that in the nature of things it requires a conversion of capital in order to pay the tax."³³ The one plain distinction on which he relies is that by a stock dividend "nothing of value is taken from the company's assets and transferred to the individual ownership of the several stockholders and thereby subjected to their disposal."³⁴ This boils down to the single fact that the corporation has taken nothing from its treasury, but has merely changed somewhat the nature of its obligation to the stockholders.

Mr. Brandeis meets this by the assertion that "segregation of assets in a physical sense is not an essential of income".³⁵ He relies on the taxability of the gains of a partner though those gains are still in the partnership chest. This will hardly do. The partner is taxed on genuine economic gains, and the partnership is overlooked. The tax on stock dividends does not disregard the corporation and it is not confined to genuine economic gains of the stockholder. Mr. Justice Brandeis tries also an oblique attack. He assumes a distribution by the corporation of stock or bonds which have been held in the treasury to be put on the market as a means of getting additional working capital. The market refuses to absorb them; so the corporation keeps the cash it had intended to distribute and placates the stockholders with a dividend in stock or bonds. The next step in the argument is a hypothetical concession that such a distribution of stock or bonds would yield taxable income to the recipient. From this follows the conclusion that the result should be the same when stock is created for the

³¹(1920) 40 Sup. Ct. 189, 195.

³²*Ibid.*, at p. 195.

³³*Ibid.*, at p. 195.

³⁴*Ibid.*

³⁵*Ibid.*, at p. 201.

express purpose of making a dividend. The trouble with this is that it is Mr. Justice Brandeis who implies the concession. The majority may still say that the corporation does not part with assets when it distributes its own stock or bonds, whatever the genesis of those securities.

So on the question of precedent and legal analysis, the line of division is whether the corporation parts with assets. What is income to the stockholder depends upon what is outgo to the corporation. The majority plant themselves firmly on this ground. Two of the minority say that it is not important whether the corporation dispenses corporate assets so long as it dispenses something which serves the same purpose from the standpoint of the stockholder. Why look at the question of stockholder's income from the angle of corporate expenditure? To the stockholder that is a mere matter of form. In substance a dividend in the stock of his corporation is just as close to cash as a dividend in the stock of a subsidiary, and the sale of a stock dividend to get cash disturbs the stockholder's relation to the corporation no more than does his use of a cash dividend for other purposes than taking his proportionate share of new issues of stock. The court has swallowed two camels. Why strain at a gnat?

The best answer seems to be that the gnat is as unpalatable and as hard to swallow as are the camels, and that it can urge a technical point not available to them. In *Lynch v. Hornby*³⁶ Mr. Justice Pitney had a hard time finding even plausible substantial reasons why a 1913 cash dividend from corporate assets accumulated before the Sixteenth Amendment is taxable income to the stockholder. He recognizes that such a dividend diminishes by so much the assets of the corporation and "in a theoretical sense reduces the intrinsic value of the stock."³⁷ This objection he dodges by saying:

"But, at the same time, it demonstrates the capacity of the corporation to pay dividends, holds out a promise of further dividends in the future, and quite probably increases the market value of the shares."³⁸

Even if this is true to some extent, it does not make the whole distribution genuine economic income except to one who had his

³⁶(1918) 247 U. S. 339, 38 Sup. Ct. 543.

³⁷*Ibid.*, at p. 346.

³⁸*Ibid.*

stock from the beginning of the period when the corporate reservoir began to fill. *Lynch v. Hornby* can be justified only by the practical convenience of treating the corporation as an economic unit distinct from the stockholders. When a corporation parts with assets, it would be confusing to insist on a nice appraisal of what the stockholder gains. But for want of such an appraisal the stockholder has to pay an income tax on what in whole or in part is not a gain to him but merely a change in the form of his capital.

This is a good place to stop. A formal or technical distinction will do to mark the limit of a doctrine which is the offspring of the formal and the technical. The similarities which Mr. Justice Brandeis adduces cannot be gainsaid. But the decisions which he picks for his base of operations cannot pass the test of substance. The artificiality of *Lynch v. Hornby* is bad enough already. It should not be allowed to breed more of its kind. A stock dividend is not genuine income even though it is substantially the same as other dividends that are not genuine income, but which have been adjudged legal income. If other dividends are severed from corporate assets and a stock dividend is not, this will do for a legal line between them.

V

This ends the report of the two major engagements in the polemic between the majority and the minority. A minor operation remains to be mentioned. Mr. Justice Brandeis provokes a skirmish by advancing the contention that we should disregard the corporate fiction and look at the tax on stock dividends as a tax on the stockholder's interest in the corporate income. Congress, he says, instead of taxing the stockholder on corporate income as it accrues, "limited the income tax to that share of the stockholder in the earnings which is, in effect, distributed by means of the stock dividend paid".³⁹ This limitation and postponement seem to be thought of as acts of mercy. "In other words to render the stockholder taxable there must be both earnings *and* a dividend paid."⁴⁰ Mr. Justice Pitney's answer makes the third division of his opinion. He says in effect that a dividend is not paid when the corporation pays nothing. So long as nothing is paid, the

³⁹ (1920) 40 Sup. Ct. 189, 201.

⁴⁰ *Ibid.*

stockholder has only an "increase in value of capital investment", which "is not income in any proper meaning of the term".⁴¹ The new certificates do not measure the extent to which gains accumulated by the corporation have made the stockholder richer, unless he has held his stock throughout the corporate operations that make the dividend possible. The corporation cannot be disregarded in order to sustain the tax, when it is only by regarding the corporation "as a substantial entity apart from the stockholders" that "any dividend—even one paid in money or property—can be regarded as income of the stockholder".⁴²

This answer is unanswerable. Mr. Justice Brandeis can say only that Congress limited the tax to "dividends representing profits earned since March 1, 1913"⁴³ and thereby mitigated the hardship inflicted by such a tax as those sustained in *Lynch v. Hornby* and *Peabody v. Eisner*. This, however, helps only those who held their stock before March 1913. Even as to them, the tax is not one which disregards the corporate fiction. If it did, it would assess them on corporate income as it accrues to the corporation. Instead, it treats accumulations of several years as stockholder's income for the year in which there is a dividend. This would not matter much if the rates were not progressive. But on account of the surtaxes it may matter considerably.⁴⁴ A further difficulty is that this tax is part of a law which also taxes corporations on their income as it accrues.⁴⁵ If Congress means

⁴¹*Ibid.*, at p. 196.

⁴²*Ibid.*, at p. 195.

⁴³*Ibid.*, at p. 202.

⁴⁴True, the surtax rates now imposed are those for the year in which the corporation accumulated the earnings. But the stock dividend is not fitted retroactively into the stockholder's income for the year whose rates are applied. It is regarded as the last increment of his income for the year in which it is received. If a stock dividend of \$50,000 is received in 1919 from corporate profits for 1917, the stockholder whose income subject to the normal tax was \$10,000 in 1917 and \$200,000 in 1919, has his \$50,000 stock dividend taxed at the 1917 rates, not for income from \$10,000 to \$60,000, but for income from \$200,000 to \$250,000. Of course, if the stockholder's fat year was 1917 and his lean year 1919, this method of assessment operates to his advantage. But where his income subject to normal tax does not vary from year to year, the method of assessing stock dividends still operates to his disadvantage whenever the dividend represents corporate earnings of more than one year.

⁴⁵The exclusion of dividends from the assessment of the normal tax on individuals made this relatively unimportant when this normal tax had the same rate as the tax on corporate income; but now that the rate on corporate income is greater than that of the normal tax on personal income, individuals doing business in corporate form pay more than those who choose to operate as a partnership.

to disregard the corporate fiction, it should disregard it. Mr. Justice Brandeis's suggestion has serious flaws, even when confined to cases in which recipients of stock dividends held their parent stock before March 1, 1913. It is palpably untenable when directed to any case in which the parent stock was acquired after all or some of the corporate accumulations which produce the stock dividend.⁴⁶

VI

The contending opinions of Mr. Justice Pitney and Mr. Justice Brandeis afford an interesting instance of legal and economic concepts playing blind man's buff with each other. Mr. Justice Brandeis starts with a realistic picture of the methods of corporate financing which shows the essential identity of two ways of cutting melons: the stock dividend, and the extraordinary cash dividend accompanied by a preferential chance to subscribe for an increase of stock. Since the latter is taxable to the stockholder as income, he says, the former should be also. His premise is one of legal income which is not genuine economic income. The legal concept of the separate individuality of the corporation and its stockholders is needed to make any dividend *per se* income to the stockholder. But, says Mr. Justice Pitney, the legal concept can get in its work only when the corporation parts with something that makes it poorer. Mr. Justice Brandeis counters by calling the stock dividend sort of a delayed pass of what is genuine economic income. His colleague answers that on the assumption of the identity of the corporation and its stockholders the pass is only from one pocket to another. If the corporation is a ghost, it cannot be a source of income. The only possible tax on the stockholder would then be on his share of the income of the corporation as it accrues. This was not the tax imposed by the statute before the court.

So far as *Eisner v. Macomber* turns on economic issues, the majority has much the better of the argument. So far as it is a game of legal concepts, the best that the minority can get is a stalemate. Mr. Justice Holmes has found the solider ground for

⁴⁶Mr. Justice Pitney writes several pages insisting strongly on the substantial distinctness between the corporation and its stockholders. For a treatment of this part of his opinion see an article entitled "The Stock-Dividend Decision and the Corporate Nonentity" in 5 Bulletin of the National Tax Association 201 (April, 1920).

dissent. He cannot be dislodged by argument. He can be met only by contradiction. Whether you take him or his opponent depends upon which you prefer. Is "incomes" to be construed according to the vulgar or as a word of art? As Marshall bids us remember, it is a Constitution we are expounding. Must every word be restricted to its nicest meaning, or shall Congress be allowed reasonable latitude to pick one of the several connotations which the word might convey to those who supported or voted for the constitutional clause in which it appears? The Sixteenth Amendment was passed to unshackle Congress from chains riveted by a much-criticised five-to-four judicial decision refusing to follow a prior unanimous decision which held that no such chains were in the Constitution. It can hardly be doubted that Mr. Justice Holmes is right when he says that "the known purpose of this Amendment was to get rid of nice questions as to what might be direct taxes."⁴⁷ The issues in *Eisner v. Macomber* seem to be whether this known purpose or the particular phraseology shall be picked as controlling; and, if the latter, whether a word may be given only its best meaning, or may have in the Constitution any of the alternative uses to which plain folks may put it. No answer to these questions can be given by philologists or economists. The answer which the Supreme Court should give depends upon its conception of its function. The members of the court do not agree in their conceptions. In this they do not differ from other members of the body politic.

THOMAS REED POWELL,

COLUMBIA UNIVERSITY

⁴⁷40 Sup. Ct. 189, at p. 204.